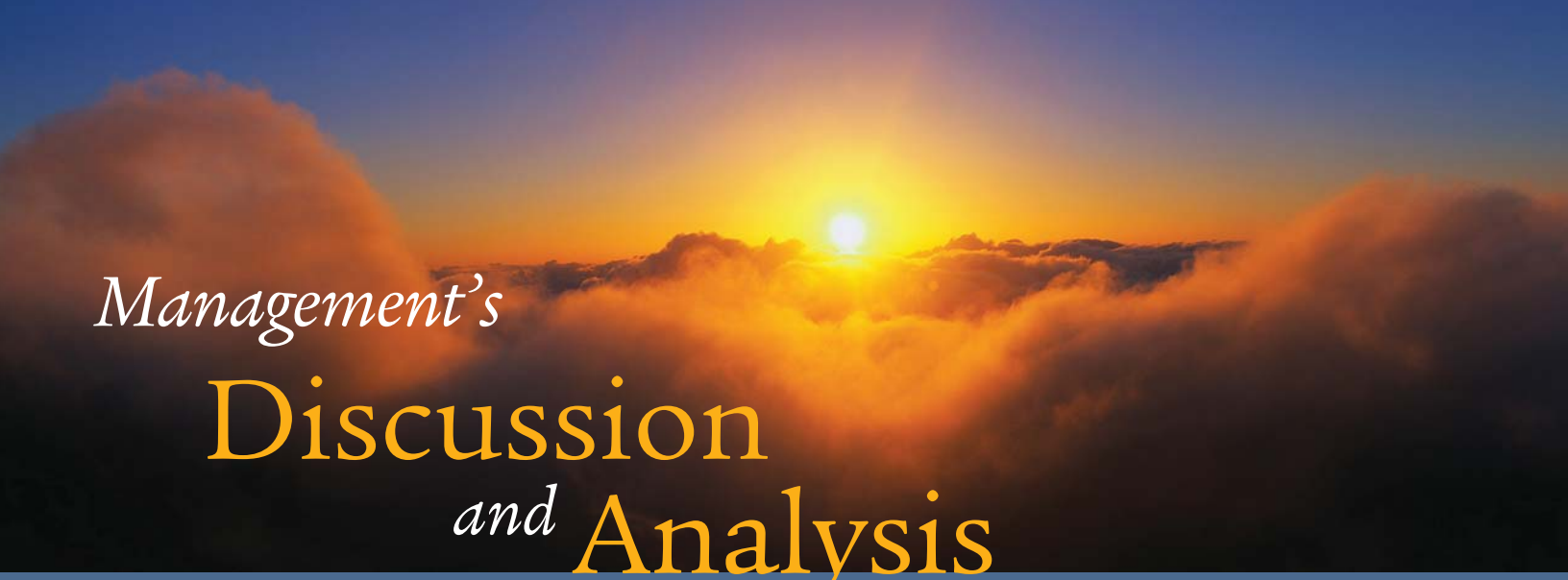


Management's Discussion *and* Analysis

Introduction

In FY 2006, the U.S. Environmental Protection Agency (EPA) celebrated 35 years of working to protect human health and the environment. Since 1970, the Agency—in collaboration with partners and stakeholders—has been delivering a cleaner, healthier environment to Americans. From regulating auto emissions to banning the use of DDT, from cleaning up toxic waste to protecting the ozone layer, and from increasing recycling to revitalizing inner-city brownfields sites, EPA's achievements have resulted in cleaner air, purer water, and better protected land.

Over the last 35 years, EPA has not only changed the way it does its business of protecting human health and the environment, but has changed the way the nation's businesses, communities and individuals view their role in protecting our environment. Today, Americans understand that environmental protection is everyone's responsibility.

But while the Agency and its partners have achieved a great deal, much work remains. The environmental problems the nation faced in FY 2006 are more complex than those of 35 years ago, and implementing solutions is more challenging. Recent national and international events, such as the devastation left by hard hitting hurricanes, the advance of Avian flu, threats to homeland security, global warming, and population growth and its associated resource consumption, are altering the environment in unprecedented ways.

EPA's Long-Term Strategic Goals

Clean Air and Global Climate Change
Clean and Safe Water
Land Preservation and Restoration
Healthy Communities and Ecosystems
Compliance and Environmental Stewardship

Scientific advances and emerging technologies offer new opportunities for protecting human health and the environment, but also pose new risks and challenges. Most of today's environmental problems cannot be solved by traditional regulatory controls alone; they will require the combined expertise, perspectives, and resources of many. More than ever before, we need to look toward the future to anticipate potential threats to human health and the environment, establish clear priorities, and prepare ourselves to address them.

The President has charged EPA with accelerating the pace of environmental protection while maintaining our nation's economic competitiveness. This report reviews the progress EPA made toward its strategic and annual performance goals during FY 2006. It fulfills the requirements of the Government Performance and Results Act and other management legislation[1] for reporting on environmental and financial performance and demonstrating results.

To help measure EPA's progress towards its mission goals and assess its success, Agency leaders established 80 annual performance goals at the beginning of FY 2006. The chapters that follow describe EPA's results in meeting these annual goals. This report also presents a picture of the Agency's financial activities and achievements during the year, because managing taxpayer dollars efficiently and effectively is critical to delivering the best results to the American people.

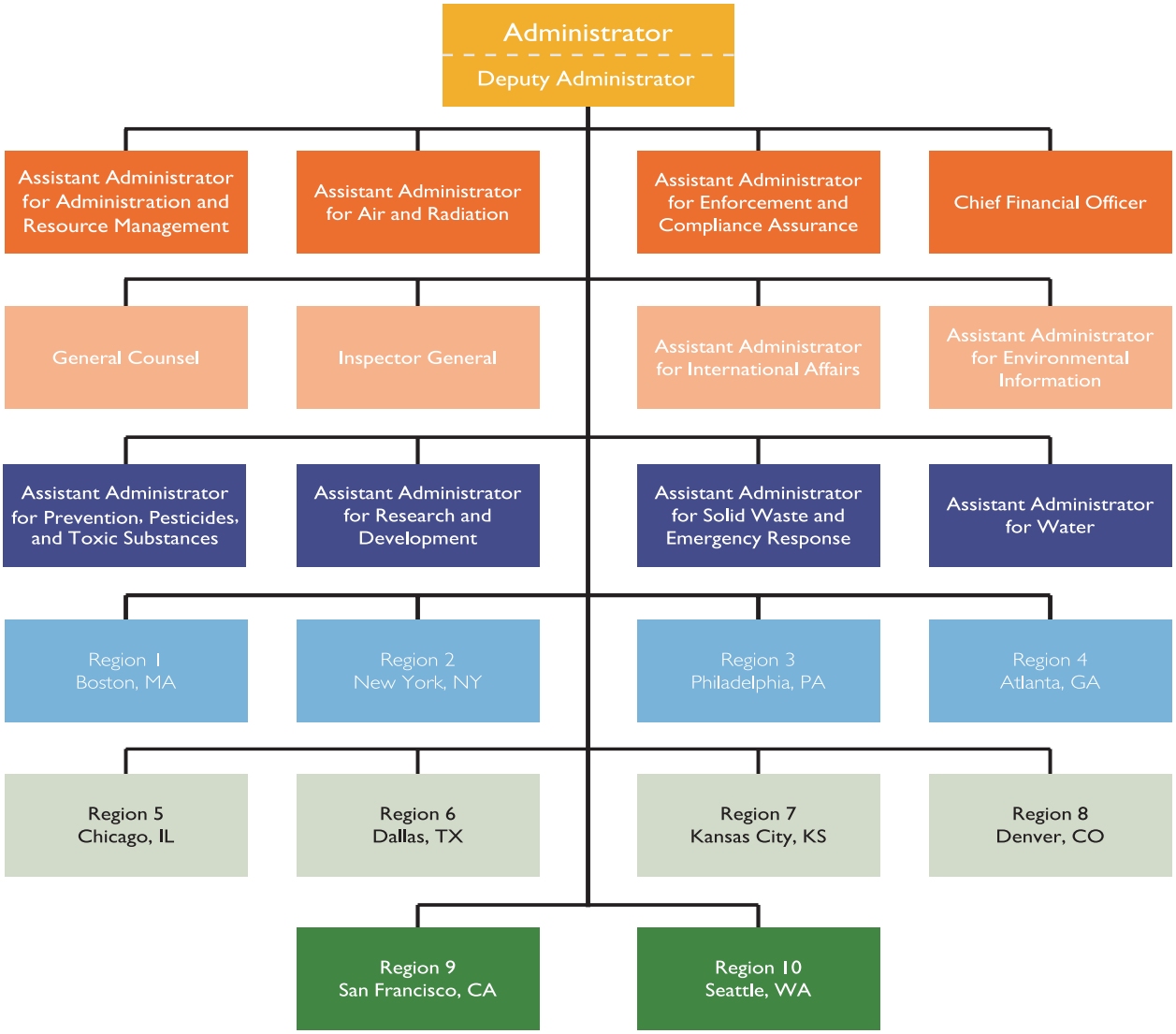
Mission and Organization

EPA has a clear mission: "To protect human health and the environment." Under this mission, the Agency assesses environmental conditions and works with its partners and stakeholders to identify, understand, and solve current and future environmental problems. The Agency develops and enforces regulations that implement national environmental laws to protect America's air, water, and land. It works with the regulated community to provide assistance and incentives for complying with environmental laws along with enforcement actions as appropriate.

EPA employs approximately 17,400 people across the country, including its headquarters offices in Washington, DC, 10 regional offices, and more than a dozen laboratories and field sites. The Agency's staff is highly educated and technically trained; more than half are engineers, scientists, and policy analysts. In addition, EPA employs legal, public affairs, financial, information management, and computer specialists. EPA Administrator Stephen L. Johnson, who was appointed by the President, is the first career scientist to lead the Agency.

U.S. Environmental Protection Agency

The mission of the Environmental Protection Agency is to protect human health and the environment.



EPA Offices

Office of the Administrator

Provides overall supervision of the Agency and is responsible directly to the President of the United States.

Office of Administration and Resources Management

Manages EPA's human, financial, and physical resources.

Office of Air and Radiation

Oversees the air and radiation protection activities, including national programs, technical policies, and regulations.

Office of the Chief Financial Officer

Manages and coordinates EPA's planning, budgeting, and accountability processes and provides financial management services.

Office of Enforcement and Compliance Assurance

Delivers compliance with U.S. environmental laws and promotes pollution prevention.

Office of Environmental Information

Advances the creation, management, and use of information as a strategic resource at EPA.

Office of General Counsel

Provides legal service to all organizational elements of the Agency.

Office of Inspector General

Conducts audits, evaluations, and investigations of Agency programs and operations.

Office of International Affairs

Manages Agency involvement in international policies and programs that cut across Agency offices and regions and acts as the focal point on international environmental matters.

Office of Prevention, Pesticides and Toxic Substances

Regulates pesticides and chemicals to protect public health and the environment and promotes innovative programs to prevent pollution.

Office of Research and Development

Meets programs' research and development needs and conducts an integrated research and development program for the Agency.

Office of Solid Waste and Emergency Response

Provides policy, guidance, and direction for safely managing waste; preparing for and preventing chemical and oil spills, accidents, and emergencies; and cleaning up and reusing contaminated property. Provides technical assistance to all levels of government to safeguard the air, water, and land from the improper management of waste.

Office of Water

Develops national programs, technical policies, and regulations relating to drinking water; water quality; ground water; pollution source standards; and the protection of wetlands, marine, and estuarine areas.

Research Triangle Park (RTP), North Carolina

The Agency's center for research on how humans and ecosystems are exposed to various pollutants, the extent of that exposure, and the health and ecological effects which result from such exposure. RTP is also the hub of EPA's air pollution programs under the Clean Air Act and home of the EPA National Computer Center.

Regional Offices

EPA has 10 regional offices, each responsible for several states and territories.

Highlights of FY 2006 Program Performance

Throughout FY 2006, the Agency collaborated closely with its partners to protect the nation's air, water and land. With resource obligations of $10.2 billion and 17,355 full-time-equivalent employees, EPA achieved significant results under each of the five long-term environmental goals established in its *2003-2008 Strategic Plan*. This section highlights the Agency's FY 2006 accomplishments and continuing performance challenges under each of its strategic goals. It also discusses EPA's accomplishments in homeland security and emergency response programs and under the President's Management Agenda. Section II of this report contains more detailed performance information.

SIGNIFICANT ENVIRONMENTAL ACCOMPLISHMENTS AND CHALLENGES

Goal 1: Clean Air and Global Climate Change. In FY 2006, EPA issued the Agency's most protective suite of national air quality standards for particle pollution ever. The standards address two categories of particle pollution: fine particles ($PM_{2.5}$) and inhalable coarse particles (PM_{10}). EPA projects that fully meeting the $PM_{2.5}$ standards will yield an estimated $9 billion to $75 billion in health benefits by reducing premature death, aggravated asthma, bronchitis, heart attacks, hospital admission for heart and lung disease, and the numbers of days that Americans miss work or school because of health symptoms related to particle pollution (http://www.epa.gov/particles).[2]

Beginning June 1, 2006, EPA required that refiners and fuel importers cut the sulfur content of highway diesel fuel by 97 percent, from 500 parts per million to 15. Ultra-low sulfur diesel is now available at retail gasoline stations. When these requirements are fully implemented, the use of the reduced-sulfur fuels will prevent nearly 8,300 premature deaths and tens of thousands of cases of respiratory ailments such as bronchitis and asthma annually. By addressing diesel fuel and engines as a single system, this action is expected to produce the clean air equivalent of eliminating air pollution from 90 percent—or about 13 million tons—of today's trucks and buses. Further, the Agency anticipates that 2.6 million tons of nitrogen oxides and 110,000 tons of particulate matter will be reduced annually (http://www.epa.gov/otaq/highway-diesel/index.htm).

In addition, EPA proposed a renewable fuels standard (RFS) in FY 2006. The RFS program is designed to reduce the nation's dependence on foreign oil by doubling the use of renewable fuels such as ethanol and biodiesel. The program, authorized by the Energy Policy Act of 2005, will promote the use of fuels largely produced by American crops.

Partnering with the Private Sector to Achieve Results

In FY 2006, EPA and the United Parcel Service (UPS) partnered to develop a delivery truck, the first of its kind, which uses EPA-patented hydraulic hybrid technology to deliver 60 to 70 percent higher fuel economy in urban driving.

With the breakthrough technology onboard, the delivery truck also lowers greenhouse gas emissions by reducing carbon dioxide (CO_2) by 40 percent, compared to conventional UPS diesel delivery trucks.

In April 2006, EPA released the latest annual report on greenhouse gas emissions, "Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990-2004," prepared for the United Nations Framework on Climate Change.[3] The report shows that the United States is making progress in reducing the emissions of some critical gases as it works toward cutting U.S. greenhouse gas intensity by 18 percent by 2012. Fossil fuel combustion was

the largest source of emissions, accounting for 80 percent of the total. The report shows that both methane and nitrous oxide emissions have decreased from 1990 levels by 10 percent and 2 percent, respectively. Overall, greenhouse gas emissions during 2004 increased by 1.7 percent from the previous year while the U.S. Gross Domestic Product grew 6.9 percent (in current dollars).[4] This increase, which occurred during a period of economic expansion, was due primarily to an increase in carbon dioxide emissions associated with fuel and electricity consumption. While the U.S. economy expanded by 51 percent from 1990 to 2004, emissions have grown by only 15.8 percent over the same period.

In FY 2006, EPA continued to address the challenges of implementing the 1990 Clean Air Act air toxics program, striving to meet court-ordered deadlines while developing data and improving capacity to take risk-based actions. EPA has a large number of rules pertaining to hazardous air pollutants scheduled for completion under different provisions of the Clean Air Act: mobile source emission standards, stationary source emission standards, and risk-based standards. In March 2006, EPA proposed a rule that would reduce air toxics from mobile sources. Once it is promulgated and fully implemented, this rule is expected to result in the reduction of 350,000 tons of air toxics annually by 2030.

EPA also provided new research findings in FY 2006 that support reviewing and implementing the National Ambient Air Quality Standards, as well as contributing fundamental information on the emission, measurement/control, and health impacts of other important hazardous air pollutants. For example, the Agency completed studies on exposure to air pollutants and health concerns, providing basic auto emission data relevant to public exposures and serving to frame a strategy to be used in detailed multi-disciplined studies planned for three U.S. locations in 2007 and 2008.

Goal 2: Clean and Safe Water.

Through the end of FY 2006, approximately 3,000 polluted waters (14 percent) identified by states in 2000 were restored or examined more closely and found to be meeting water quality standards. In FY 2006, permits implementing standards for industrial sources, municipal treatment plants and stormwater, under EPA's National Pollutant Discharge Elimination System, prevented the discharge of 31 billion pounds of pollutants.

EPA worked with states to improve state water quality monitoring strategies across the country in FY 2006 and released an innovative statistically valid survey of the condition of streams nationwide, the first in a planned series of national assessments of the condition of aquatic resources.[5] According to the streams survey results, 28 percent of U.S. streams are in good condition; 25 percent in fair condition; 42 percent in poor condition. In addition,

Restoring Drinking Water and Wastewater Services In the Aftermath of Hurricanes Katrina and Rita

In FY 2006, EPA, along with local water systems, state environmental agencies, and health departments, undertook extraordinary efforts to restore drinking water and wastewater services in the aftermath of Hurricanes Katrina and Rita.

EPA monitored the status of drinking water and wastewater systems, provided technical assistance for emergency repairs and system assessments, and supplied mobile labs for testing water samples.

To protect public health, the Agency also provided educational materials in English, Spanish, and Vietnamese.

during the past year's swimming season (calendar year 2005), coastal and Great Lake beaches were open and safe for swimming 97 percent of beach season days, exceeding EPA's FY 2006 goal of 94 percent.

During FY 2006, EPA completed the modernization of the Safe Drinking Water Information System (SDWIS), a national database that tracks information on the quality of the public's drinking water. The modernization will greatly improve the accuracy of the data collected and address 3 of 5 identified historical data quality issues: difficulty getting drinking water data into the system, the high cost of storing and processing the data, and difficulty in getting data out of the system. The Agency is fully addressing the remaining data quality issues through two Data Reliability Action Plans (2000 and 2003). In FY 1999 less than 50 percent of the data in the system were accurate and complete; in FY 2007 the Agency will work toward the 2011 goal of ensuring that 90 percent of data are accurate and complete.

EPA and its partners face significant challenges in ensuring that Americans served by community water systems receive safe drinking water. To protect public health, each day the more than 52,000 community water systems nationwide must deliver water that meets health based standards for more than 90 chemical, radiological, and microbial contaminants. Water systems are faced with applying these existing standards, as well as with implementing new ones. Moreover, drinking water and municipal wastewater infrastructure that was constructed in the 1970s and 1980s is deteriorating. Demands on this aging infrastructure are further increasing by a steadily growing population's needs for drinking water supplies, wastewater treatment, and storm water management. Drinking Water State Revolving Funds (DWSRFs) provide low-interest loans to support needed improvements to infrastructure, and EPA is working with states to ensure that DWSRFs are sustainable over the long term.

Goal 3: Land Preservation and Restoration. In FY 2006, EPA added five new hazardous waste sites that pose risks to human health and the environment to the National Priorities List (NPL) of Superfund sites. That brings the total to 1,246 final NPL sites which have been identified for possible long-term cleanup by EPA's Superfund program. Contaminants found at these final and proposed sites include arsenic, chromium, benzene, dichloroethene, dieldrin, dioxin, lead, pentachlorophenol, polychlorinated biphenyls, toluene, toxaphene, trichloroethene, tetrachloroethene, xylene, zinc and other heavy metals.

EPA completed the cleanup ("construction completes") and reduced risks posed to human health at 40 sites on the NPL in FY 2006. Since the Superfund Program's inception, the Agency has completed all remedial cleanup construction activities at 1,006 Superfund sites, more than 80 percent of the 1,246 sites on the NPL. In addition, by the end

Pittsburgh Increases Recycling at Pirates' Baseball Games

In FY 2006, Pittsburgh baseball fans began helping the environment by recycling. In early July, EPA and the City of Pittsburgh began encouraging fans to "recycle on the go" by depositing their cans and bottles in bins in the tailgate area and at other key locations across their baseball stadium.

Pittsburgh adopted EPA's "Recycle on the Go" philosophy as part of a comprehensive plan to increase recycling participation in the city. Revenue generated from the collected recyclable material will benefit Pittsburgh youth programs.

According to municipal authorities, Pittsburgh collects on average 20,000 tons of recyclable material per year, which is below the national average reported by similar cities. In FY 2006, Mayor Bob O'Conner challenged the city to double the city's collection to 40,000 tons—to "make Pittsburgh one of the cleanest, safest cities in America."

EPA's "Recycle on the Go" initiative works with partners like the City of Pittsburgh to encourage people to recycle wherever they go by making recycling easy and convenient. EPA is working toward a 35 percent national recycling rate by 2008. Recycling saves energy, conserves resources, reduces the need for new landfills and incinerators, and stimulates the development of green technologies.

of FY 2006, EPA controlled site contamination posing unacceptable risks to human health at an additional 34 sites and controlled the spread of groundwater contamination at 21 additional sites, exceeding the Agency's FY 2006 targets. The complexity of the sites remaining on the NPL will present significant challenges to EPA over the next few years.

Under the Agency's hazardous waste management program under the Resource Conservation and Recovery Act (RCRA), EPA met its FY 2006 goal for increasing the number of hazardous waste management facilities with approved controls in place to prevent dangerous releases to air, soil, and groundwater and is on track to bring 95 percent of facilities under approved controls by FY 2008. Further, more than 89 percent of high priority facilities requiring RCRA corrective action have met Agency goals for preventing human exposure to hazardous waste under current land and groundwater uses, and more than 74 percent have met goals for having controls in place to prevent groundwater migration.

In FY 2006, EPA's state and tribal partners completed 14,493 cleanups of leaking underground storage tanks, exceeding the Agency's target of 13,600. This includes 43 cleanups in Indian country. EPA will continue to work with states to complete cleanups and reduce the backlog of 116,949 cleanups not yet completed. Since the beginning of the Agency's Underground Storage Tank Program, EPA has cleaned up more than 75 percent (or 350,818) of all reported releases.

EPA has made significant progress toward meeting its FY 2006 municipal solid waste (MSW) reduction goals of diverting 83.1 million tons of MSW and maintaining a daily per capita generation of MSW at 4.5 pounds. According to 2004 and 2005 data, the last 2 years for which the Agency has data, the nation generated more than 245.7 million tons of solid waste and recycled more than 79 million tons. Data in support of the FY 2006 goals will be available in FY 2008. During FY 2006, EPA targeted its efforts to encourage the reduction and recycling of the most significant waste streams: paper, organic wastes, containers and packaging, and electronics.

Goal 4: Healthy Communities and Ecosystems. Throughout FY 2006, EPA worked to reduce risks to communities, homes, workplaces, and ecosystems. The Agency reviewed new chemicals and pesticides for unacceptable risks to human health and the environment before they were put on the market. EPA also reassessed risks posed by older pesticides and established new risk mitigation measures where needed. By the end of FY 2006, the Agency had reassessed 99.1 percent of the pesticide tolerance levels (legal limits on pesticide residues in food) requiring reassessment under the 1996 Food Quality Protection Act. EPA will reassess the five remaining chemicals in FY 2007.

Under EPA's High Production Volume (HPV) Challenge Program, the Agency identifies and addresses risks posed to human health and the environment by chemicals currently in commerce. In FY 2006, EPA released the HPV Information System, a searchable on-line database that provides all the known toxicity data on HPV chemicals. By the end of calendar year 2006, EPA will provide the public with critical health and environmental effects data on 1,710 chemicals.

Data released in 2005 by the Centers for Disease Control demonstrated major reductions in the incidence of childhood lead poisoning—from approximately 900,000 children with elevated blood lead levels in the early 1990s to 310,000 children from 1999 to 2002. These findings indicate major progress towards EPA's 2008 strategic target for reducing the incidence of childhood lead poisoning to 90,000 cases as well as toward the federal goal to eliminate this disease as a public health concern by 2010.

Because the remaining population of at-risk children is often difficult to reach and evidence has shown a higher incidence of childhood lead poisoning among low-income than non-low income children, in FY 2006 EPA established a second long-term goal for the Lead Program to reduce the disparity in blood lead levels between low- and non-low-income children. In addition, the Agency refined its public education and outreach efforts to reduce exposure to at-risk children and launched a targeted grant program aimed at reducing the incidence of child lead poisoning in vulnerable populations. To reduce children's exposure to hazards created by

Protecting Children from Lead Poisoning In Boston

Elevated blood lead levels in young children can trigger learning disabilities, decreased growth, hyperactivity, impaired hearing, and even brain damage.

In FY 2006, EPA's Region 1 Office worked with the city of Boston to reduce blood lead levels in children.

Elevated blood lead levels in children were reduced from 1,123 cases in 2001 to 497 cases in 2006. This represents an 18.5 percent decrease from 2005.

renovation, remodeling, and painting that disturb lead-based paint, EPA proposed a major new rule in FY 2006 to establish lead-safe work practices and is currently working to finalize this rule.

The Agency's National Estuary Program continued to implement key actions to protect 28 nationally significant estuaries and coastal habitat, including protecting an estimated 140,000 acres. In FY 2006, EPA began taking actions to improve the Great Lakes Ecosystem under the Great Lakes Regional Collaboration Strategy, including remediating contaminated sediments.

According to the U.S. Fish and Wildlife Service's 2006 *National Wetlands Inventory Status and Trends Report*, acreage of some wetland types is on the increase overall—wetland gains exceeded wetland losses from 1998 to 2004 at a rate of 32,000 acres per year. However, vegetated estuarine wetlands—the wetland areas with significant ecological value—continued to decrease and vegetated estuarine wetland areas that provide significant flood protection continue to decrease at an increasing rate. The loss of vegetated estuarine wetlands is most vivid on the Louisiana coast. EPA faces many challenges over the next few years in protecting critical ecosystems. Among other challenges, the Agency will work to accelerate the rate of progress in restoring the Chesapeake Bay and reduce nutrient loadings, a major source of non-point source pollution, in the Gulf of Mexico.

Goal 5: Compliance and Environmental Stewardship.

In FY 2006, EPA achieved an estimated 890 million pounds of reduced, treated, or eliminated pollutants. This represents an increase of 440 million pounds over the Agency's original FY 2006 target of 450 million pounds.[6]

In addition, the Agency settled several important civil and criminal enforcement cases this year that will significantly improve human health and environmental quality. For example, EPA reached a settlement with two coal fired power plants, Minnkota Power Cooperative and Square Butte Electric Cooperative, that will result in a 132 million pounds reduction in air pollution, a $5 million investment in renewable energy, and better pollution control technology that will dramatically reduce sulfur dioxide and nitrous oxides—chemicals linked to respiratory impairment in humans, acid rain, and smog in North Dakota and downwind areas.[7]

Environmental stewardship programs achieved significant environmental results in FY 2006 through voluntary efforts to prevent pollution before it is released into the environment. Work conducted under the Federal Electronics Program Challenge using the Electronics Products Environmental Assessment Tool reduced the use of hazardous materials by 2.7 million pounds, conserving 250 billion BTUs of energy and saving $5.6 million in federal costs related to purchasing and managing electronic equipment.[8] In FY 2006, EPA's Green Suppliers Network (GSN) expanded efforts to include the Aerospace, Automotive, Healthcare/Pharmaceutical, and Office Furniture sectors. In FY 2006 the GSN program completed 36 technical reviews that have identified more than $22.4 million in potential cost savings from clean environmental opportunities.[9]

Winners in the Presidential Green Chemistry Challenge Program's five FY 2006 Awards categories[10] collectively accounted for 145 million pounds of hazardous materials reductions, bringing cumulative totals to 750 million pounds and 550 million gallons of water saved since 1995.[11] In addition, through promotion of pollution prevention and stewardship opportunities, the Design for the Environment's Furniture Flame Retardancy Partnership replaced 19 million pounds of pentaBDE with safer flame retardants through FY 2006.[12] PentaBDE has been accumulating in human tissues and breast milk over the last two decades. Some animal studies demonstrate that exposure can damage the thyroid and liver and cause hyperactivity, changes in motor behavior, and other brain functions.

HOMELAND SECURITY AND EMERGENCY RESPONSE

Homeland security and responding to environmental emergencies is a top priority for the Agency and the nation. For the past several years, EPA has worked with other federal agencies to protect human health and the environment from intentional harm. The Agency plays a lead role in supporting the protection of critical water infrastructure and coordinating the development of national capabilities and strategies to address chemical, biological, and radiological contamination during a terrorist event. In FY 2006, the Agency conducted the following key homeland security and emergency response work:

- **Protecting Community Drinking Water Systems:** By the end of FY 2006, 100 percent of all large and medium community drinking water systems had conducted vulnerability assessments and submitted to EPA emergency response plans based on the findings of the assessments. Of the nation's small systems, 98 percent had completed vulnerability assessments and 96 percent had created emergency response plans.
- **Developing a Contamination Warning System:** In FY 2006, EPA launched a pilot water contamination warning system at a drinking water utility. This warning system will increase the utility's ability to quickly detect and respond to contamination threats and incidents in its drinking water distribution system.
- **Training Water Utilities in Water Security:** To complement the contamination warning system pilot mentioned above, the Agency provided training and technical assistance on effective water security activities to approximately 125 large water utilities in FY 2006.
- **Establishing Guidelines for Exposure to Hazardous Chemicals:** In FY 2006, the Agency developed short-term exposure limits and health effects guidelines for an additional 23 extremely hazardous substances to which the general population could be exposed during a terrorist incident or chemical accident,

In FY 2006, EPA Became the First Federal Agency to Purchase 100 Percent Green Power

Fostering renewable energy production and developing better renewable technologies benefits the environment, expands the diversity of our energy supply, and improves the reliability of our power supply systems. Through its purchases, onsite renewable energy systems, and outreach efforts, EPA supports the development of the green power market, which is a critical component in the long-term strategy to protect our environment.

EPA is the first major federal agency to purchase green power equal to 100 percent of its estimated annual electricity use nationwide. As of September 1, 2006, EPA is purchasing nearly 300 million kilowatt hours of green power annually in the form of either renewable energy certificates or delivered product. This amount is equal to 100 percent of the total estimated annual electricity consumption at all of EPA's nearly 200 facilities across the country—enough electricity to power 27,970 homes for an entire year.

bringing the total number of chemicals for which these guidelines have been developed to 184.

- Working with Department of Homeland Security: In FY 2006, EPA worked with the Department of Homeland Security (DHS) to update the National Response Plan in light of lessons learned from Hurricanes Katrina and Rita.

SUMMARY OF PERFORMANCE DATA

Goals Met. In its *FY 2006 Annual Plan*, EPA committed to 80 annual performance goals (APGs). In FY 2006, the Agency met 29 of these APGs, 64 percent of the APGs for which data were available at the time this report was published. FY 2006 results to date reflect a decrease in the percentage of APGs met from FY 2005; last year, EPA met 67 percent of its APGs for which data were available.

EPA significantly exceeded its targets for a number of its FY 2006 APGs. In many of these cases, the Agency had established new performance goals or measures for FY 2006—evidence of its continuing effort to improve its measures and sharpen its focus on environmental outcomes. For some of these new measures, the Agency may have lacked the trend data or experience it needed to determine ambitious yet realistic targets and consequently set FY 2006 targets conservatively.

Goals Not Met. Despite their best efforts, however, EPA and its partners were not able to meet all planned targets for FY 2006. EPA

Hurricanes Katrina and Rita: One Year Anniversary

On August 29, 2005, Hurricane Katrina made landfall along the Gulf coast of the southeastern United States, causing unprecedented damage from eastern Louisiana to near Mobile, Alabama, due to the high winds and storm surge. Over the past year, EPA has worked with federal, state and local partners to assist in the recovery from Hurricanes Katrina and Rita. To date, EPA has:

Conducted environmental monitoring and sampling of water, air, floodwater and residual sediment resulting in more than 400,000 analyses

Responded to approximately 70 emergency situations to address chemical spills, fires, and other emergencies causing an immediate public threat

Played a key role in the overall debris mission with the Federal Emergency Management Agency and the U.S. Army Corps of Engineers, for which the total estimates are expected to top 118 million cubic yards. EPA provided technical advice and assistance, promoted recycling, and handled the disposal of over 4 million containers of household hazardous waste

Assisted in the proper handling and recycling of over 380,000 large appliances (refrigerators, freezers, and air conditioners)

Collected and recycled over 661,000 electronic goods to save important landfill space and ensure the reuse of metal components

Assessed approximately 4,000 water systems to determine their viability after the storms and provide assistance where requested; inspected over 3,500 potable water trucks to ensure drinkable water was delivered promptly to areas affected by the hurricane

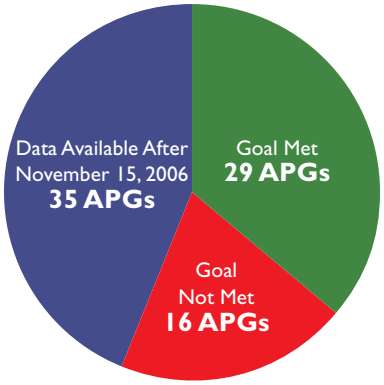
Assessed approximately 1,300 underground storage tank locations and over 1,600 chemical facilities and refineries

Assessed approximately 900 public and parochial school chemistry classrooms and removed chemicals and other equipment from 130 chemistry laboratory classrooms to ensure safe schools for returning students

Continued to monitor 12 temporary ambient air monitoring sites throughout Louisiana

Continued to provide oversight of the cleanup by Murphy Oil of a large oil spill which impacted hundreds of homes in St. Bernard Parish.

EPA's FY 2006 Performance Results



Summary of FY 2006 Performance Results by Goal

Result	Goal 1	Goal 2	Goal 3	Goal 4	Goal 5	ESP	Total
Met	4	6	4	10	1	4	29
Not Met	2	1	1	6	6	0	16
Data Available After November 15, 2006	14	13	2	4	1	1	35
Total	**20**	**20**	**7**	**20**	**8**	**5**	**80**

did not meet 16 of the 45 FY 2006 APGs for which performance data were available. The Agency is considering the various causes of these shortfalls as it adjusts its annual goals and program strategies for FY 2007 and beyond.

There are a number of reasons for these missed goals. In some cases, unexpected demands on resources or competing priorities prevented EPA and its partners from meeting FY 2006 targets. For example, EPA completed 157 Superfund lead-removal actions and 93 voluntary removal actions with EPA oversight, falling short of its FY 2006 targets of 195 and 115 actions, respectively (APG 3.6). However, these lower-than-expected results are directly related to the Agency's continued response to Hurricanes Katrina and Rita—the largest hurricane and cleanup effort in EPA's history. In support of the Katrina response effort, the Agency analyzed hundreds of thousands of drinking water, air, floodwater, and sediment samples; responded to emergencies posing an immediate public health threat; worked with other agencies to remove contaminated debris; and supported recycling and other efforts which diverted resources from Superfund removal actions and resulted in a missed FY 2006 goal.

In other cases, in its commitment to develop meaningful goals and measures that evidence environmental outcomes, the Agency may have overestimated its ability to achieve annual results. Working with its Chesapeake Bay Program partners, EPA set an ambitious FY 2006 goal for reducing nitrogen, phosphorous, and sediment pollution loads entering the Chesapeake Bay (APG 4.15). This FY 2006 goal was established to accord with 2010 deadlines outlined in the Chesapeake 2000 agreement. However, despite expanded implementation efforts by EPA, states, and others, pollution reduction strategies have not improved water quality conditions in the Bay to the extent envisioned by Bay Program partners. Continued growth in communities and farms in the region have affected progress, and EPA is implementing several key strategies designed to increase the current pace of restoration. As another example, to support management of persistent bioaccumulative toxic chemicals worldwide, EPA set a new FY 2006 goal for collecting mercury use and emission inventory data for key industry sectors in China and India (APG 4.2). While an assessment of mercury use and emissions for the power sector was completed for China, monitoring and reporting on mercury stack emissions in India has been delayed while discussions about the sector continue.

EPA may also miss an annual performance goal due to the difficulty of forecasting a performance target or as a function of its measurement scheme. Under the Performance Track Program, members collectively meet targets for reducing water use, energy use, materials use, nonhazardous solid waste, air releases, and discharges to water (APG 5.6). While EPA's goal for FY 2006 was to meet targeted reduction levels in all six media/resource areas, it met only three—for waste usage, water use, and discharges to water. However, these lower-than-anticipated results are not representative of fewer improvements, but rather of the effect that large facilities have on aggregate Performance Track results. In FY 2006, while the number of facilities making small improvements increased, fewer

large facilities reported "high magnitude" results than did in previous years. Performance Track does not dictate members' selection of commitment indicators nor controls the size of facilities that apply to program, so determining when the program will meet its targets is difficult. Growing interest in program and increasing emphasis on meeting targets, however, suggests Performance Track will be on track to meet FY 2007 targets.

A different issue related to measurement explains the Agency's missed goal for the percentage of the population served by community water systems (APG 2.1). In FY 2006, while the vast majority of the nation's community water systems supplied drinking water that met all applicable health-based drinking water standards, some very large systems serving a large number of people reported short-term violations during the year. Even these brief episodes of noncompliance significantly affected annual performance results. As a result, though final FY 2006 data is not yet available, EPA anticipates missing this goal. To account for the time-limited nature of these kinds of noncompliance events, the Agency has developed a new performance measure which is included in its *2006-2011 Strategic Plan*.

Certain contractual or technological issues largely outside EPA's control may also contribute to missed annual goals. The Agency let a contract to provide information about new, commercial-ready environmental technology that influences users to purchase effective environmental technology in the United States and abroad and established an annual goal related to this assessment (APG 5.8). However, the Agency discontinued the project due to poor contractor performance. Then, in response to subsequent budget cuts, funds originally targeted for this work were shifted to higher priority needs. As a result, the Agency missed this annual goal and does not plan to resume this effort. Similarly, in FY 2006 EPA planned to purchase 51 state-of-the-art radiation monitoring units to be deployed to sites based on population and geographical coverage (APG 1.12). Due to delays in siting, however, the Agency reduced its order to 41 monitors to avoid a backup of monitors waiting to be installed. Subsequently, technical difficulties arose concerning the monitors first installed, and shipment of additional monitors was suspended until the problem could be resolved.

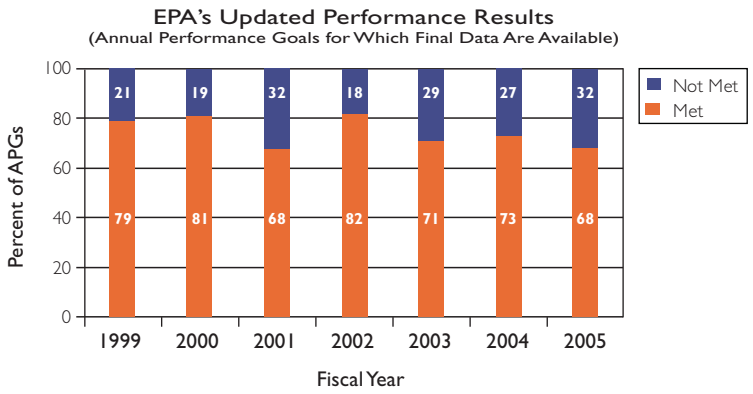
Data Unavailable. Because final end-of-year data were not available when this report went to press, EPA is not yet able to report on 35 of its 80 APGs, an increase over the 33 APGs for which data were not available in EPA's FY 2005 report. This difference is largely attributable to the Agency's increased focus on achieving longer-term environmental and human health outcomes, rather than activity-based outputs. Environmental outcome results may not become apparent within a federal fiscal year, and assessing environmental improvement often requires multi-year information. As a result, EPA may not yet have the data required to determine whether an FY 2006 APG such as reducing exposure to and health effects from priority industrial chemicals (APG 4.6) has been met. Many variables are involved in evaluating progress toward this goal, and it takes time to understand exposure and the impact of these chemicals on human health. Over 90 percent of the measures

for which EPA does not yet have final performance data are outcome-oriented.

In other cases, reporting cycles—including some which are legislatively mandated—do not correspond with the federal fiscal year on which this report is based. Data reported biennially or on a calendar year basis, for example, are not yet available for this report. In some cases, such as for certain compliance and enforcement information, the Agency has adjusted data collection and QA/QC processes to meet the November 15 date for submitting this report. To provide as much information as possible on its progress toward achieving its goals, however, EPA continues to present the most current data available.

Furthermore, EPA obtains performance data from local, state, and tribal agencies, all of which require time to collect the information and review it for quality. Often, EPA is unable to obtain complete end-of-year information from all sources in time to meet the deadline for this report. The Agency is working to reduce such delays in reporting, however, by capitalizing on new information technologies to exchange and integrate electronic data and information, improve data quality and reliability, and reduce the burden on its partners.

Data Now Available. The Agency is now able, however, to report data from previous years that became available in FY 2006. Final performance results data became available for 20 of the 33 FY 2005 APGs on which the Agency did not report in its *FY 2005 Annual Report*. Of these 20 FY 2005 APGs, EPA met 14. For example, the Agency met its FY 2005 goal for 20 percent of source water areas for community water systems achieving minimized risk to human health (FY 2005 APG 2.7). EPA also met its suite of four FY 2005 goals focused on the number of people living in areas with monitored ambient concentrations below the NAAQS for PM_{10}, $PM_{2.5}$, $CO/NO_2/SO_2$/lead, and 8-hour ozone (FY 2005 APGs 1.1-1.4). EPA can now report achieving 48 (68 percent) of the 84 FY 2005 APGs for which it has data. For FY 2004, EPA can now report achieving 58 (73 percent) of the 79 APGs for which it has performance data. Delays in reporting cycles and targets set beyond the fiscal year continue to affect one APG for FY 2003.



Note: During FY 2006, final performance results data became available for a number of APGs from prior years: 20 for FY 2005, 5 for FY 2004, 1 for FY 2003, and 1 for FY 2002.

Improving Measures and Adjusting Targets. EPA is continuing to develop better and more meaningful measures of its performance. In FY 2006, the Agency introduced 36 new or improved performance measures. Equipped with better data, EPA is also adjusting performance targets to reflect an improved understanding of current conditions and the outcomes to be achieved. For example, the Agency is adjusting its target for the number of inspections and exercises conducted at oil storage facilities that are required to have facility response plans, in the event of a release of a harmful substance (APG 3.6). New data has allowed the Agency to determine more accurately the number of these facilities nationwide, and thus to set a more appropriate target. EPA will continue to benefit from improved data, revising annual performance measures and adjusting targets to provide a more useful assessment of its progress.

Financial Analysis

In FY 2006, EPA had resources of $13.5 billion to support the achievement of its strategic goals. Of this amount, the Congress provided $7.8 billion (58.2 percent) in the form of direct FY 2006 appropriations and $3.1 billion (23.1 percent) available from prior years. In addition, EPA received $1.2 billion (8.9 percent) in spending authority from offsetting collections (including $544.4 million for the Hurricane Katrina cleanup effort) and payments from the public for fees, fines, and penalties. The Agency also had other resources of $1.4 billion (9.8 percent). (See Chart I.)

EPA's net cost of operations in FY 2006 was $8.3 billion. (See Chart II.)

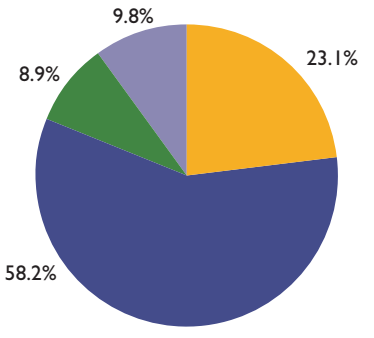
Forty-six percent of this amount was spent performing the goal related to Clean and Safe Water ($3.8 billion) and 19 percent was spent on Land Preservation and Restoration ($1.6 billion).

The majority of the costs (56 percent) in accomplishing the Agency's goals are for grant programs with the states, tribes, and universities. During FY 2006, EPA awarded $4.7 billion in grants to assist in accomplishing its mission. EPA also maintains partnerships with other federal agencies and uses commercial contractors to achieve its program goals. (See Chart III.)

EPA leverages its own resources through innovative financing mechanisms. The Agency uses partnerships with the states to manage the resources in the Clean Water and Drinking Water State Revolving Funds to keep the nation's water clean and safe. As of September 30, 2006, the Clean Water State Revolving Fund has leveraged nearly $24 billion in federal capitalization grants into more than $57 billion in assistance to municipalities and other entities for wastewater projects. And as of June 30, 2006, the Drinking Water State Revolving Fund has leveraged nearly $7.3 billion in federal capitalization grants into more than $11 billion in assistance to municipalities and other entities for drinking water infrastructure projects.

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) authorizes EPA to retain and use the proceeds from settlement agreements to conduct cleanup activities. These funds are placed in interest-bearing site specific special accounts. As of September 30, 2006, EPA had 612 special accounts with $243 billion in receipts, which earned $40 million in interest during the fiscal year.

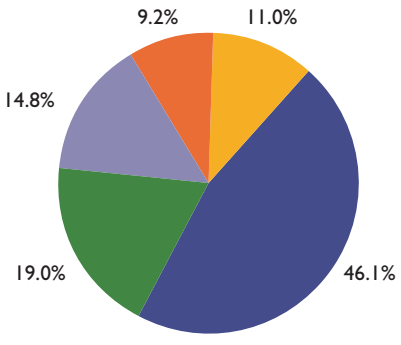
Chart I: FY 2006 Resources



Source: FY 2006 Combined Statement of Budgetary Resources

- Unobligated Balance Brought Forward
- Appropriations
- Spending Authority from Offsetting Collections
- Other

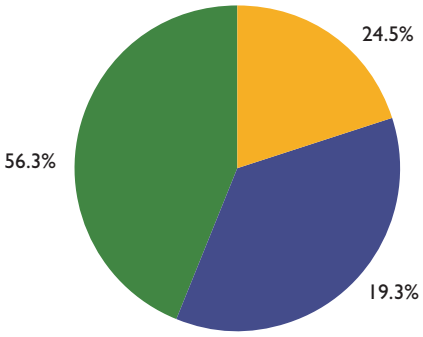
Chart II: FY 2006 Net Cost By Goal



Source: FY 2006 Statement of Net Cost by Goal

- Clean Air and Global Climate Change
- Clean and Safe Water
- Land Preservation and Restoration
- Healthy Communities and Eosystems
- Compliance and Environmental Stewardship

Chart III: How Our Work Gets Done
(Based on Percent of Total Dollars)



Source: ORBIT Report by BOC

- EPA Employees
- Contractors & Other Federal Agencies
- States, Tribes & Universities

EPA IS FINANCIALLY ACCOUNTABLE

Effective stewardship of public resources

High standards of financial performance

Low incidence of improper payments

Measuring Success

Clean audit opinions for 7 consecutive years

No material weaknesses for 5 consecutive years

"Green" PMA scores for Improved Financial Performance for 3 consecutive years

Accelerated financial reporting deadlines met for 3 consecutive years

Improper payments of less than 0.50 percent for 3 consecutive years

FY 2006 Accomplishments

Migrated payroll management to another federal service provider (E-Government initiative)

Achieved "Green" PMA score for Eliminating Improper Payments

Implemented Katrina Stewardship Plan

Implemented Office of Management and Budget Circular A-123, Management's Responsibility for Internal Control

Retooled internal budget process to expand accountability

On the Horizon

A new financial management system

An administrative data warehouse for improved access to and reporting of administrative data

Measures to increase efficiency of operations

The *Environmental Finance Program* helps regulated parties find ways to pay for environmental activities through an Environmental Finance Advisory Board, an on-line data base, and a network of nine university-based Environmental Finance Centers. For every dollar that EPA has invested in the Environmental Finance Program, the network has raised $3.71 in project work.

HIGHLIGHTS OF FINANCIAL PERFORMANCE

EPA is equally committed to protecting human health and the environment and to being accountable for and an effective steward of the public's resources. The Agency's financial management measures of success include implementing effective internal control and providing accurate financial information and timely financial reporting. EPA has a number of initiatives underway that support the Agency's management strategy for improved financial performance. The progress and results of these initiatives are presented below and in the section on Improving and Integrating Financial Information of this Performance and Accountability Report.

Consolidating Financial Processes and Services

EPA is consolidating its financial functions from 14 regional offices to four Finance Centers to improve efficiency of accounting operations and customer service. Under EPA's consolidation plan, functions associated with vendor payments were transferred to EPA's Research Triangle Park Finance Center, and financial functions associated with travel were transferred to EPA's Cincinnati Finance Center in FY 2006. In addition, six regions transferred some of their functions associated with grants to EPA's Las Vegas Finance Center and some financial functions associated with accounts receivable to EPA's Cincinnati Finance Center. All remaining finance operations will be transferred in FY 2007. Overall, EPA estimates that consolidating accounting functions from 14 locations into four Finance Centers will produce a net savings of $3 to $6 million annually.

Katrina Stewardship Plan

After Hurricane Katrina devastated the Gulf Coast of the United States on August 29, 2005, OMB issued guidance for agencies to implement stewardship plans that documented their internal controls to mitigate any waste, fraud, and mismanagement. Implementing EPA's

Stewardship Plan has afforded the Agency a higher level of confidence in its financial activities and will allow management to make better assessments of risk for future emergencies.

As of September 30, 2006, EPA had received $544.5 million in funding from the Federal Emergency Management Agency and Army Corps of Engineers for the Hurricane Katrina relief effort. Of this amount, EPA had obligated $475.5 million, plus an additional $13.6 million of its own funds, for a total of $489.1 million. EPA disbursed $344.4 million of the $489.1 million as of September 30, 2006.

Improper Payments

In FY 2006, the Agency achieved a "Green" as its status under the President's Management Agenda for the progress made in significantly decreasing improper payments in the Clean Water and Drinking Water State Revolving Funds (SRFs).

EPA had low error rates in a statistical sampling of payments to direct recipients Agency-wide and to sub-recipients in two states. In addition, no improper payment issues were found in an analysis of payments to sub-recipients in a third state. Based on EPA's ability to demonstrate that its internal controls are adequate, OMB has granted the Agency a 3-year relief from measurement and annual reporting on payments in the two SRFs. Additional reporting details required by the Improper Payments Improvement Act (IPIA) are provided in Section IV, Annual Financial Statements of this Performance and Accountability Report.

EPA's Improper Payment Reduction Effort Clean Water and Drinking Water SRFs

Fiscal Year	Target Error Rate	Actual Error Rate	Actual Improper Payments (dollars in millions)
FY 2003	Baseline	0.51%	$12.4
FY 2004	0.49%	0.47%	$10.3
FY 2005	0.45%	0.13%	$3.0
FY 2006	0.40%	0.18%	$3.5
FY 2007	0.35%	—	—
FY 2008	0.30%	—	—

Grants Management

Under the Agency's Grants Management Plan, EPA has put in place a comprehensive strategy to address its grants management weakness. In implementing the Plan, the Agency is adjusting its corrective actions as necessary to fully address the grants management challenges faced by the EPA. The Agency is creating a new culture that places a premium on transparency, accountability and results, with a view to making EPA a 'best practice' agency for grants management. The table

Performance Measures	Target	Progress in FY 2006
Percentage of grants managed by certified project officers	100%	99.1%
Percentage of new grants subject to the competition order that are competed	90%	95.0%
Percentage of new grants to non-profit recipients subject to the competition order that are competed	90%	90.8%
* Percentage of active recipients who receive advanced monitoring	10%	8.4%
Percentage of advanced monitoring reports closed within 120 days	90%	93.8%
Percentage of eligible grants closed out	99% in 2004 90% in 2005	99.4% in 2004 96.6% in 2005
** Percentage of grant workplans that include a discussion of qualitative environmental results	80%	100%

* This performance measure is tracked on a calendar year basis.

** This performance measure is based on a sample of grants awarded in FY 2005.

below lists the Agency's grant performance measures and the results achieved in FY 2006.

GOVERNMENT-WIDE FINANCIAL PERFORMANCE MEASUREMENTS

The U.S. Chief Financial Officers Council publishes Government-wide performance measures on the "Metric Tracking System" (MTS) website at http://www.fido.gov/mts/cfo/public. These measures are a series of key financial management indicators that allow government financial managers, Congress and other stakeholders to assess the financial performance of each agency.

During FY 2006, the Agency's performance improved from yellow to green in one metric, from red to green in one metric, and remained unchanged in the other seven metrics. EPA is currently green in seven of nine metrics.

EPA improved its performance in several areas in FY 2006. *Under Electronic Payments*, the Agency is up to paying 95.9 percent of its invoices electronically, in line with its goal of 96.0 percent. The goal for *Delinquent Accounts Receivable* from the Public over 180 Days is 10 percent or less and EPA improved by reducing its delinquency rate from 68 percent to 25 percent.

Government-Wide Financial Performance Metrics

Financial Management Indicator	Rating September 2005	Rating September 2006
Amount in Suspense (Absolute) Greater than 60 Days Old	🔴	🟢
Delinquent Accounts Receivable from the Public Over 180 Days	🔴	🔴
Electronic Payments	🟡	🟡
Percent Non-Credit Invoices Paid On-Time	🟡	🟢
All Other:[13] Fund Balance with Treasury, Net Interest Penalties Paid Purchase Card Delinquency Rates Travel Card Delinquency Rates-Individually Billed Travel Card Delinquency Rates-Centrally Billed	🟢	🟢

The Agency is taking aggressive action to improve the financial indicators for which a green status has not been achieved and plans to maintain its performance in areas where it is already successful. EPA will improve its performance in the metric on *Delinquent Accounts Receivable from the Public over 180 Days* by completing consolidation of its accounts receivable accounting function, updating its policies and procedures, and taking a more aggressive approach to managing receivables. Through consolidation of vendor payments at one location, EPA expects to improve its performance in the metric on *Electronic Payments*.

ANALYSIS OF FINANCIAL STATEMENTS AND STEWARDSHIP INFORMATION

Audit Results

For the seventh consecutive year, EPA received an unqualified opinion on its consolidated financial statements. However, the auditors identified two reportable conditions, one noncompliance issue that was not considered substantial, and no material weaknesses. EPA takes pride in its progress in reducing the number of reportable conditions in the annual audit from ten to two between the FY 2005 audit and the FY 2006 audit.

Overview of Financial Position

The following discussion summarizes key financial information and significant variances between FY 2005 and FY 2006 in

the Agency's financial statements. EPA's Financial Statements appear in Section IV, Annual Financial Statements, of this Performance and Accountability Report.

Assets: The Agency had total assets of $17.8 billion at the end of FY 2006. The decrease of $382 million from FY 2005 primarily resulted from a decrease in the Fund Balance with Treasury partly offset by increased investments in the Hazardous Substance Trust Fund (Superfund) and the Leaking Underground Storage Tanks Trust Fund (LUST), as well as increased payments in FY 2006 for grants and activities associated with the Hurricane Katrina cleanup effort and increased software and equipment assets.

Liabilities: The Agency had total liabilities of $1.6 billion at the end of FY 2006, which is reported in the Consolidated Balance Sheet and summarized in the following table.

Assets, U.S. Environmental Protection Agency

	FY 2006 (in thousands)	FY 2005 (in thousands)
Fund balance with Treasury	$11,173,443	$12,139,207
Investments	$5,366,264	$4,811,065
Accounts Receivable, Net	$371,551	$440,728
Loans Receivable	$30,836	$39,347
Property Plant and Equipment, Net	$756,794	$708,716
Other Assets	$63,431	$5,134
Total Assets	**$17,762,319**	**$18,144,197**

Liabilities, U.S. Environmental Protection Agency

	FY 2006 (in thousands)	FY 2005 (in thousands)
Accounts Payable and Accrued Liabilities	$833,192	$850,114
Debt Due to Treasury	$18,896	$21,744
Custodial Liability	$32,963	$142,347
Cashout Advances, Superfund	$223,760	$270,811
Payroll and Benefits Payable	$195,746	$190,394
Pensions and Other Actuarial Liabilities	$39,408	$39,380
Environmental Cleanup Costs	$10,083	$6,989
Commitments and Contingencies	$8	$1,950
Other Liabilities	$234,256	$204,594
Total Liabilities	**$1,588,312**	**$1,728,323**

The decrease of $140 million (8.1 percent) from FY 2005 is primarily the result of significant decreases in the Custodial Liability and Cashout Advances, Superfund accounts. Fines and penalties, interest assessments, repayments of loans, and other miscellaneous accounts receivable that, when collected, will be deposited to the Treasury General Fund are considered Custodial Liability. Cashout Advances are funds received under settlement agreements to finance response action costs at specified Superfund sites. (See Notes 12 and 16 in Section IV, Annual Financial Statements).

Net Position: The Agency's Net Position at the end of FY 2006 was $16.2 billion, a $242 million decrease from the previous year's total of $16.4 billion. This decrease is primarily attributable to lower undelivered orders and unobligated balances (Unexpended Appropriations) at the end of the year. Specific details are provided in Note 17 in Section IV. An increase in Cumulative Results of Operations due to the increase in Earmarked Funds for Superfund and LUST activities was not sufficient to offset the decrease in Unexpended Appropriations.

Net Cost of Operations: The Agency's Net Cost of Operation for FY 2006 rose by $312 million (from $8.0 to $8.3 billion) over FY 2005. This increase was primarily related to activities associated with the Hurricane Katrina cleanup effort and to increased grant payments. For FY 2006, EPA's Net Cost of Operations of $8.3 billion consisted of Gross Costs of $9.2 billion, less Earned Revenue of $0.9 billion. Most of this amount, $3.8 billion (46.1 percent) was spent performing the goal related to "Clean and Safe Water." Net

costs totaling $1.6 billion (18.9 percent) were spent on Land Preservation and Restoration.

Statement of Budgetary Resources: This Statement provides information on resources available to EPA and the status of those resources at the end of the fiscal year.

The Agency's total budgetary resources of $13.5 billion for FY 2006 were $221 million more than the budgetary resources for FY 2005, primarily because of increased reimbursements related to the Hurricane Katrina cleanup, which are also reflected in the increased reimbursable obligations. EPA's total obligations were $10.2 billion and total net outlays were $8.3 billion.

Stewardship Information

Under the requirements of OMB Circular A-136, Financial Reporting Requirements, EPA reports on one area of Required Supplementary information—Stewardship Land (PP&E). In addition, the Agency reports three areas of Required Supplementary Stewardship information—Research and Development, Infrastructure (clean water and drinking water facilities), and Human Capital (awareness training). More information on these is provided in Section IV of this Performance and Accountability Report.

Statement of Budgetary Resources

	FY 2006 (in thousands)	FY 2005 (in thousands)
Total Budgetary Resources	$13,452,220	$13,231,189
Obligations Incurred:		
Direct	$9,292,415	$9,573,696
Reimbursable	$912,718	$550,737
Total Obligations Incurred	**$10,205,133**	**$10,124,433**
Gross Outlays	$10,607,195	$9,918,889
Less Collections and Receipts	($2,291,623)	($1,999,386)
Total, Net Outlays	**$8,315,572**	**$7,919,503**

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b).

While the statements have been prepared from the books and records of the entity in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. Other limitations are included in the footnotes to the principal statements.

EPA's FY 2006 Management Integrity and Audit Management Reports

In FY 2006, EPA's Administrator provided his unqualified Statements of Assurance on overall internal controls and internal controls over financial reporting. The Agency continues to make progress in strengthening its management practices and the internal controls carried out by the Agency to assure the integrity of its programs and operations.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish and maintain internal controls and financial systems that provide reasonable assurance that federal programs and operations are protected from fraud, waste, abuse, and misappropriation of federal funds. FMFIA holds agency heads accountable for correcting deficiencies and requires them annually to identify and report internal control and accounting systems problems and planned remedies.

In FY 2005 OMB issued its revised Circular A-123, *Management's Responsibility for Internal Control*, which provides guidance on using the range of tools agency managers have at their disposal to achieve desired program results and meet FMFIA requirements. The revised Circular requires agencies to submit a separate statement attesting to the effectiveness of internal controls over financial reporting as of June 30 of each year (revised Circular A-123, Appendix A).

In FY 2006, EPA broadened its management integrity process to meet the new internal control requirements under Appendix A of the revised Circular. The Agency developed a communications strategy that explained to managers and executives at all levels that strong internal controls contribute to operating efficiency; provide greater accountability; reduce fraud, waste, and mismanagement; and promote cost-effective results. With the assistance of an independent contractor, EPA documented, tested, and assessed 195 key controls associated with 10 financial reporting processes and selected transactions associated with Hurricane Katrina.

The assessment uncovered no material weaknesses and found the Agency's internal control mechanisms were operating effectively. However, 11 internal controls were classified as reportable conditions, and several others were classified as less significant deficiencies. EPA developed corrective action plans and milestones for these reportable conditions and, as of September 30, 2006, seven were resolved, and the remaining four are scheduled for correction in FY 2007. EPA plans to create a "Controls Portfolio Analysis" for one financial process to document the value of an A-123 assessment in terms of improved efficiency and cost effectiveness. The next cycle of internal control assessments will begin with a follow-up review of

the effectiveness of the corrective actions for all reportable conditions and continue with an assessment of the financial processes selected for review in FY 2007.

Based on EPA's self-assessment of its internal controls and financial systems, Agency managers have determined that the Agency's controls are achieving their intended objectives. The Administrator's unqualified Statement of Assurance on the Agency's overall internal controls and its internal controls over financial reporting for FY 2006 follows.

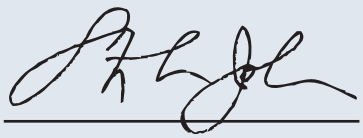
Fiscal Year 2006 Annual Assurance Statement

I am pleased to give an unqualified statement of assurance that the U.S. Environmental Protection Agency's (EPA) programs and resources are protected from fraud, waste, abuse, and mismanagement. Based on EPA's annual self-assessment of its internal management controls and financial control systems, I can reasonably assure that there are no material weaknesses in the Agency's control.

Stephen L. Johnson
Administrator
November 13, 2006

Fiscal Year 2006 "Unqualified" Annual Assurance Statement on Internal Controls Over Financial Reporting

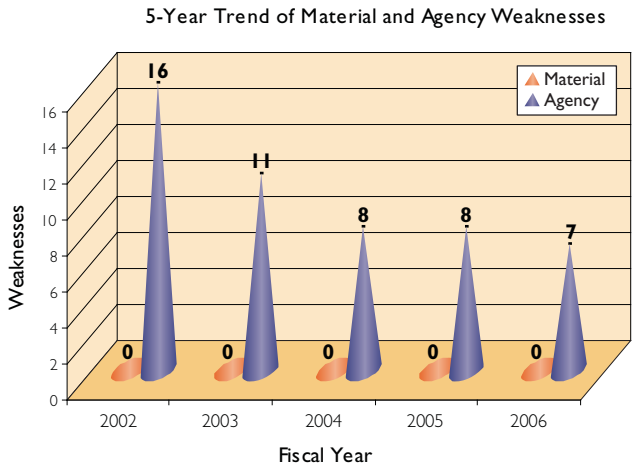
The U.S. Environmental Protection Agency's (EPA) management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. EPA conducted its assessment of the effectiveness of its internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control.* Based on the results of this evaluation, I can provide reasonable assurance that internal control over financial reporting as of June 30, 2006 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.



Stephen L. Johnson
Administrator
November 13, 2006

MANAGEMENT ASSURANCES

To identify management issues and monitor progress in addressing them, EPA's senior leaders use a system of internal program evaluations and independent audit reviews conducted by the Government Accountability Office, EPA's OIG, and other oversight organizations to assess program effectiveness. In FY 2006, for the fifth year, EPA has no material weaknesses to report under FMFIA. Material weaknesses are control deficiencies that could adversely impact the integrity of Agency programs and activities and/or violate statutory, judicial, or regulatory requirements. These deficiencies significantly impair or threaten fulfillment of the Agency's mission and must be reported to the President and Congress along with the Agency's corrective action strategy to remedy the problem. While the Agency reported no new material weaknesses, EPA currently has a number of less severe, internal Agency-level weaknesses. Agency-level weaknesses, which are not required to be reported outside the Agency, are tracked by EPA senior managers who meet periodically to ensure that progress is being made to resolve the issues. During the year, EPA closed one of its existing Agency-level weaknesses related to water quality standards. Three of the



Agency's current weaknesses were identified by OIG as management challenges under the Reports Consolidation Act of 2000 (RCA). The RCA requires the Inspector General to identify, briefly assess, and report annually the most serious management and performance challenges facing the Agency. Unlike material or Agency-level weaknesses, management challenges are not control deficiencies under FMFIA, unless specifically declared so by the Administrator, but require an Agency response to the IG's assessment of the issues identified. (See Section III, *Management Accomplishments and Challenges*, for detailed information on EPA's Key Management Challenges.)

INSPECTOR GENERAL ACT AMENDMENTS OF 1988

The Inspector General (IG) Act Amendments require federal agencies to report to Congress on their progress in carrying out audit recommendations. EPA uses audit management as a tool in assessing its progress and its ability to meet its strategic objectives. The Agency is continuing to strengthen its audit management practices and is working to address issues and complete corrective actions in a timely manner.

EPA's Audit Follow-up Activities: In FY 2006, EPA was responsible for addressing OIG recommendations and tracking follow-up activities on 634 audits. The Agency achieved final action (completing all corrective actions associated with an audit) on 359 audits, including Program Evaluation/Program Performance, Assistance Agreement, Contracts, and Single audits. The OIG questioned costs of more than $63.3 million, and recommended to disallow costs and put funds to better use in 226 of the 359 audits. After careful review, OIG and the Agency agreed to disallow approximately $39.6 million of these questioned costs and $10 million funds put to better use (see table, line D). As required by the IG Act Amendments, the following table presents information on audits that involve disallowed costs and funds put to better use.

A broader discussion of EPA's FY 2006 audit management activities are summarized below. These activities include audits with associated dollars (represented in the table above) as well as audits without dollars.

- **Final Corrective Action Not Taken.** At the end of FY 2006, 244 audits were without final action and not yet fully resolved. (This total excludes the 31 audits with management decisions under administrative appeal by the grantee—see write-up below.)

EPA's Agency Weaknesses

1. Safe Drinking Water Information System (SDWIS)
2. Clean Water Act Section 305(b) Reporting
3. Human Capital*
4. EPA's Use of Assistance Agreements to Accomplish Its Mission*
5. Agency Efforts in Support of Homeland Security*
6. Permit Compliance System
7. Implementation of Data Standards

* OIG identified these weaknesses as management challenges in its 2006 list of key management challenges for the Agency.

For more details on EPA's Agency-level weaknesses and progress in addressing them, refer to Section III—Management Accomplishments and Challenges.

EPA's Key Management Challenges Reported by the Office of Inspector General

1. Managing for Results
2. Agency Efforts in Support of Homeland Security*
3. Data Standards and Data Quality
4. EPA's Use of Assistance Agreements to Accomplish Its Mission*
5. Emissions Factors for Sources of Air Pollution
6. Human Capital Management*
7. Voluntary, Alternative, and Innovative Practices and Programs
8. Efficiently Managing Water and Wastewater Resources and Infrastructure
9. Information Technology Systems Development and Implementation
10. Data Gaps

* EPA acknowledges these challenges as Agency-level weaknesses and is tracking progress under the FMFIA process.

For more details on OIG's Key Management Challenges and EPA's response, refer to Section III—Management Accomplishments and Challenges

- **Final Corrective Action Not Taken Beyond 1 Year.**
  Of the 244 audits, EPA officials had not completed final action on 34 audits within 1 year after the management decision (the point at which OIG and the Action Official reach agreement on the corrective action plan). Because the issues to be addressed may be complex, Agency managers often require more than 1 year after management decisions are reached with OIG to complete the agreed-upon corrective actions.
- **Audits Awaiting Decision on Appeal.**
  EPA regulations allow grantees to appeal management decisions on financial assistance audits that seek monetary reimbursement from the recipient. In the case of an appeal, EPA must not take action to collect the account receivable until the Agency issues a decision on the appeal. At the end of FY 2006, 31 audits were in administrative appeal.

Disallowed Costs & Funds Put To Better Use
October 1, 2005 - September 30, 2006

Category	Disallowed Costs Number	Disallowed Costs Value	Funds Put to Better Use Number	Funds Put to Better Use Value
A. Audits with management decisions but without final action at the beginning of FY 2006.	56	$ 71,883,901	1	$ 2,002,296
B. Audits for which management decisions were made during FY 2006:				
(i) Management decisions with disallowed costs. (54)				
(ii) Management decisions with no disallowed costs. (179)	233	$ 33,975,596	7	$49,382,454
C. Total audits pending final action during FY 2006. (A+B)	289	$105,859,497	8	$51,384,750
D. Final action taken during FY 2006 Recoveries: (*)	221	$ 39,631,896	5	$10,031,750
a) Offsets		$ 1,108,261		
b) Collections		$ 3,026,689		
c) Value of Property		$0		
d) Other		$ 32,735,931		
(ii) Write-offs		$ 790,451		
(iii) Reinstated through grantee appeal.		$ 1,970,569		
(iv) Value of recommendations completed.				$ 2,059,069
(v) Value of recommendations management decided should/could not be completed.				$ 7,972,681
E. Audit reports needing final action at the end of FY 2006. (C-D)	68	$66,227,601	3	$41,353,000

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agencies' financial management systems substantially comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger. In response to the FY 1999 financial statement audit, EPA implemented an FFMIA remediation plan to improve the Agency's financial management systems to comply with federal financial system requirements. Currently, EPA has completed all but two corrective actions: security certification policy for contractor personnel and security certification policy for grantee personnel. EPA anticipates completing these actions by the first quarter of FY 2007. The Agency continues to improve cost accounting and reconciliation of intragovernmental transactions.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT

The Federal Information Security Management Act (FISMA) directs federal agencies to conduct annual evaluations of information security programs and practices to ensure that information security controls over information resources supporting federal operations and assets are effective. EPA's October 1, 2006 FISMA Report highlights the results of the Agency's annual security program review, completed by EPA's Chief Information Officer, senior agency program officials, and Inspector General. The report reflects EPA's continued efforts to ensure that information assets are protected and

secured in a manner consistent with the risk and magnitude of the harm resulting from the loss, misuse, or unauthorized access to or modification of information. In FY 2006, EPA reported no significant deficiencies in its information security systems under FISMA.

IMPROPER PAYMENTS INFORMATION ACT

The Improper Payments Information Act (IPIA) of 2002, Public Law 107-300, requires agencies to review their programs and activities to identify those considered "high risk" for significant improper payments. Because EPA has been able to demonstrate effective internal controls in eliminating improper payments, OMB has granted relief from the annual reporting requirement for the Clean Water and Drinking Water SRFs, the two high-risk programs. However, the Agency may be required to re-initiate measurement activities if there are any substantial changes to the programs (legislation, funding, etc.) that may affect payment accuracy.

GOVERNMENT MANAGEMENT REFORM ACT—AUDITED FINANCIAL STATEMENTS

The Government Management Reform Act of 1994 amended the requirements of the Chief Financial Officers Act of 1990 by requiring the annual preparation and audit of agency-wide financial statements. EPA's statements are audited by the Inspector General, who issues an audit report on the principal financial statements, internal controls, and compliance with laws and regulations.

For seven consecutive years, the Agency submitted timely financial statements and received an unqualified audit opinion—another important aspect of accountability. These statements (presented in Section IV of this report) present the Agency's financial position at the end of fiscal year.

The President's Management Agenda

Over the past 5 years, the President's Management Agenda (PMA) has challenged federal agencies to be "citizen-centered, results-oriented, and market-based" (see http://www.whitehouse.gov/results). During FY 2006, EPA made progress under each of the seven government-wide PMA initiatives: Human Capital, Competitive Sourcing, Expanded E-Government, Improved Financial Performance, Budget and Performance Integration, Eliminating Improper Payments, and Research and Development.

Each quarter, the Office of Management and Budget (OMB) releases an executive scorecard that uses a color-coded "stop light" system that rates each federal agency's progress and overall status under each of the PMA initiatives. During FY 2006, OMB did not issue a PMA scorecard for EPA's Research and Development Investment Criteria because the requirements for that initiative were under review. As of September 2006, the Agency achieved six out of six "Green" scores for progress toward implementation and four out of six "Green" scores on the status of PMA initiative implementation.

In addition to tracking PMA progress on a quarterly basis, federal agencies establish yearly goals for where they would be "Proud to Be" on the status of PMA initiative implementation. The Proud to Be milestones and goals are set every July and assessed during the third quarter PMA Scorecard process. This past year, three of EPA's PMA Initiatives achieved a "Green" rating on Proud to Be Goals: Competitive Sourcing, Financial Performance, and Eliminating Improper Payments. More information about the Agency's work under the PMA is available at http://www.epa.gov/pmaresults.

EPA's FY 2006 Progress Under the President's Management Agenda

INITIATIVE	STATUS[14]	PROGRESS	PROUD TO BE (07/06) RESULTS	HIGHLIGHTS
Human Capital			"Yellow" EPA did not meet its goal of "Green" for P2B3 EPA has set a goal of "Yellow" for P2B4	—Completed HR, IT, & leadership competency assessments, identified gaps, developed plans and began gap closure efforts. —Completed Agency Strategic Workforce Plan using competency-based planning approach. Developed and obtained OPM approval of Succession Management Plan. —Implemented SES mobility program and decreased SES hiring time. —Completed first cycle of 5-tier Performance Appraisal System (PARS). Expanded PARS improvement beta sites to ensure expectations cascade and align. Maintained an average GS hiring target well below the OPM 45-day target. Developed and obtained approval from the Office of Personnel Management of EPA Human Capital Accountability System to ensure optimal management of EPA human resources.

EPA's Challenges in Human Capital—Use a competency assessment tool to evaluate Agency leaders and priority Mission Critical Occupations (MCOs). Redirect and refocus our recruitment approach and use of development opportunities to close identified competency gaps. Ensure that PARS expectations cascade from the proper level and are visible, competency-based, and outcome oriented. Concerted effort must continue in order to meet the OPM 30-day SES hiring standard.

EPA's FY 2006 Progress Under the President's Management Agenda

Initiative	Status[14]	Progress	Proud to Be (07/06) Results	Highlights
Expanded E-Government			"Yellow" EPA did not meet its goal of Maintaining "Green" for P2B3 EPA has set a goal of "Green" for P2B4	EPA demonstrated the existence of adequate procedures for identifying systems that require Privacy Impact Assessments and System of Records Notices. E-Rulemaking successfully resumed agency implementation of the Federal Docket Management System and Initiated all scheduled and approved agency deployments. EPA has posted 100% of its grants on the website "Grants.gov"
EPA's Challenges in E-Gov—Like many other agencies, EPA will continue to face funding challenges for E-Government activities until Congressional appropriators grow more comfortable with the value proposition offered by E-Government and Line of Business projects overall. The E-Rulemaking Program Management Office (PMO) successfully managed to work through the funding freeze in 2006, but if funds are similarly frozen in 2007 it could have additional impacts on the E-Rulemaking project.				
Improved Financial Performance			"Green" EPA met its goal of "Green" for P2B3" EPA has set a goal of "Green" for P2B4	—EPA delivered its FY 2006 Performance and Accountability Report with audited financial statements by the required deadline of November 15, 2006, and issued its interim financial statements within the required deadline of 21 days after the end of the quarter. —No material weaknesses were identified during EPA's testing of 195 key controls associated with financial reporting processes as part of the Agency's assessment of internal control activities under OMB Circular A-123 (see EPA's "unqualified statement of assurance," signed by the Administrator, as of June 30, 2006). —EPA successfully demonstrated the viability of its Data Integration Green Plan, the blueprint for producing timely, useful, and usable information to drive program results. —In FY 2006, under the Data Integration Green Plan, EPA successfully assessed the types of financial/grant information needed to improve overall decision making for grants management and made substantial progress in developing the capability to produce this information. EPA has selected emergency management as the next area for review.
EPA's Challenges in Improved Financial Performance—No challenges at this time.				
Budget and Performance Integration			"Yellow" EPA did not meet its goal of "Green" for P2B3. EPA has set a goal of "Green" for P2B4.	—The Agency received green progress scores for all four quarters in FY 2006. —EPA worked cooperatively with OMB on the 2006 Program Assessment Rating Tool (PART) process, completing 51 PART assessments to date. —At the conclusion of the 2006 PART Appeals process, EPA has developed or is developing efficiency measures for 45 of its 51 PARTed programs. —Overall momentum remains strong as Agency focuses on demonstrating results in current PART reviews, works to improve consideration of performance information in its internal planning & budget processes, and devotes significant attention to developing appropriate efficiency measures that meet PART standards.

EPA's FY 2006 Progress Under the President's Management Agenda

INITIATIVE	STATUS[14]	PROGRESS	PROUD TO BE (07/06) RESULTS	HIGHLIGHTS
EPA's Challenges in Budget and Performance Integration (BPI)—EPA must continue to develop appropriate OMB-approved measures that gauge the efficiency of an environmental program's administration. Each program evaluated by the PART is required to have at least one OMB-approved efficiency measure.				
Eliminating Improper Payments			"Green"—EPA met its goal for P2B3. EPA has set a goal of "Green" for P2B4.	—EPA's error rate for payments to direct recipients of State Revolving Funds (SRF) is 0.00 percent, and an analysis of sub-recipient payments in three states, including targeted sampling in two of those states, indicates that total improper payments in those states are well below the OMB's threshold error rate of 2.5 percent of total program dollars and $10 million. —EPA has received OMB's approval of a three-year relief from annual reporting or measurements for the SRF programs based on the low error rate for the past two years. EPA may be required to resume measurement activities if there are substantial changes to the program that may affect payment accuracy.
EPA's Challenges in Eliminating Improper Payments—No challenges at this time.				
Research and Development Investment Criteria		EPA has not received a quarterly scorecard evaluating progress on implement-ing the R&D Investment Criteria during FY 2006	NA	—The Board of Scientific Counselors (BOSC), an independent, external panel, reviewed the following research programs in FY 2006: Global Change, Land Protection and Restoration, and Water Quality Research. —Four of the Agency's research programs were reviewed in the 2006 PART process: Global Change, Human Health Risk Assessment, Land Protection and Restoration, and Water Quality Research. ORD has made significant progress negotiating with OMB and the Board of Scientific Counselors to develop long-term measures derived from an independent expert review process. —In the 2006 PART process, EPA developed an OMB-accepted efficiency measure for the Water Quality Research Program. The Agency is determining if other research programs could benefit from utilizing a similar efficiency measure. —Beginning in FY 2007, EPA's Annual Research Planning process expanded to include regular discussions about resources and performance in the context of the R&D Investment Criteria.
EPA's Challenges in Research and Development—EPA continues to work to attain acceptable performance and efficiency measures for all of its research programs. To this end, EPA has established a workgroup comprised of representatives from OMB, the BOSC, and EPA's Office of Research and Development to develop measures that are meaningful to program managers and clearly illustrate performance over time.				

Improving Performance, Results, and Management

EPA aims to be an organization in which performance measures are well-defined and understood, managers use accurate and timely performance and financial analyses to make decisions, and costs can be linked to performance and results. The Agency continues efforts to provide decision makers with performance and resource information to help them plan and manage their programs most effectively and to expand the amount of real-time information available to managers by improving our systems and reporting capabilities. In FY 2006, EPA collaborated with states, tribes, and other partners to strengthen its approaches to tracking and assessing progress. Internally, the Agency implemented measures to hold its senior managers more accountable for achieving results. EPA continues to pursue greater operating efficiency and effectiveness so that tax payer dollars are used wisely to achieve environmental results.

STRENGTHENING PLANNING AND ACCOUNTABILITY

With the release of the Agency's *2006-2011 Strategic Plan* in September 2006, EPA more clearly identified the environmental and human health outcomes the Agency expects to achieve over the next 5 years. A primary focus of the *Plan* revision effort was to increase the outcome-orientation of EPA's long-term measures, including taking better advantage of the Agency's ongoing efforts to develop improved environmental indicators for its *Report on the Environment* and improved performance measures under the Office of Management and Budget's (OMB's) Program Assessment Rating Tool (PART). *The 2006-2011 Plan* retains the five-goal structure of the Agency's 2003 strategic plan and discusses important new challenges and opportunities facing EPA in the coming years. It emphasizes the significant contributions of the Agency's federal, state, tribal, and local partners and reflects the importance of strong collaboration. The new *Plan* also expands on EPA's more significant geographic initiatives, and emphasizes tribal issues, environmental justice concerns, and innovation and environmental stewardship.

Collaboration with Partners

EPA's effective collaboration with its partners—states, tribes, and other federal agencies—is essential to address the increasingly complex environmental challenges. The Agency continued to advance the Environmental Council of the States (ECOS)-EPA Partnership and Performance Work Group, a senior-level oversight body governing ongoing efforts to strengthen the state-EPA partnership. In FY 2006, the Work Group focused on implementing OMB's directive in the FY 2007 President's Budget requiring that EPA develop a standardized template that states will use to present

Enhancing Tribal Environmental Management

In FY 2006, EPA continued to work with tribes on a government-to-government basis to protect the land, air, and water in Indian country. In September, the Quinault Indian Nation hosted, the National Tribal Forum on Environmental Science, attended by more than 350 tribal and federal officials to discuss current science issues related to environmental and public health problems in Indian country.

As of FY 2006, 90.4 percent of tribes (517 tribes) have access to EPA funds for hiring environmental program staff, managing environmental activities, and implementing multimedia environmental programs in Indian country.[15] This represents an increase of approximately 5 percent a year since 1996, when 36 percent of tribes had access.

performance measures in FY 2007 work plans. EPA and ECOS are jointly developing templates that link to EPA's *Strategic Plan*, provide consistent requirements for regular performance reporting, and allow for meaningful comparisons of states' past and planned activities. State grant performance information will be tracked annually using EPA's Annual Commitment System (ACS) and reports generated for OMB using the Reporting and Business Intelligence Tool. During FY 2007, EPA and states will work to examine state reporting burden and streamline performance measures.

The Agency streamlined and simplified the ACS, making it more user-friendly for EPA decisionmakers by reducing the number of unnecessary output measures more than 16 percent from previous years. The system now allows state grant template measures to be flagged and tracked on an annual basis. EPA expects to continue this work in FY 2007, improving state grant performance measures, reducing the number and improving the meaning of measures in the ACS, and identifying opportunities for reducing state reporting burden.

Finally, the Agency took steps to hold its senior managers more accountable for achieving results on an annual basis. For example, in FY 2006, the Agency began linking senior manager awards to annual results achieved under EPA's strategic goals. In addition, internal planning and budget discussions required senior managers to conduct a more rigorous analysis of performance information to explain and defend their current level of program resources. In FY 2006, the Deputy Administrator also initiated a "Quarterly Management Report" under which senior managers from across EPA report to the Administrator every 3 months on a suite of critical performance and management indicators.

USING THE PROGRAM ASSESSMENT RATING TOOL AND PROGRAM EVALUATION

EPA uses OMB's PART assessments and individual program evaluations and audits to inform policy making, facilitate allocation of resources, and improve environmental outcomes while ensuring the most effective and efficient use of taxpayer dollars.

The PART is a series of diagnostic questions used to assess and evaluate programs across a set of performance-related criteria, including program design and purpose, strategic planning, program management, and results. To date, EPA and OMB have completed PART reviews for 51 of the Agency's programs. In FY 2006, the Agency conducted PART assessments on an additional eight programs and one reassessment of the Alaska Native Village Water Infrastructure program, which will be available in February 2007.

PART-assessed programs are assigned ratings of "Effective, Moderately Effective, Adequate, Ineffective, or Results Not Demonstrated" based on the responses and evidence prepared to address PART questions. The PART assessment was first used in 2002 in developing the federal

FY 2004 budget. During that year, only 1 of EPA's 11 assessed programs was rated "Adequate." The remaining ten programs received "Results Not Demonstrated" ratings. At the conclusion of the 2005 PART cycle, EPA advanced its PART standings so that 37 out of 43 assessed programs were rated "Adequate" or "Moderately Effective." This improvement in PART ratings illustrates EPA's commitment to designing and implementing programs that achieve environmental outcomes through more effective and efficient operations.

Section II.1 of this report lists PART assessments conducted for programs under each of the Agency's five strategic goals and provides a separate table of future PART measures along with the year EPA expects to begin reporting data against them. Section II.2 identifies all performance measures associated with the PART and reports FY 2006 results for the measures where data are currently available. Ratings for the new programs assessed during 2006 for the FY 2008 budget will be available with the release of the President's Budget on February 5, 2007. EPA PART ratings, as well as the ratings for other assessed federal programs, are publicly accessible at: http://www.Expectmore.gov.

As a final step in the PART evaluation, EPA and OMB agree to a series of PART follow-up actions, also known as improvement plans, which are implemented in response to PART findings. PART Improvement Plans are intended to link budgeting and performance and to create a cycle of continuous program improvement to help programs reach their environmental goals more effectively. Follow up actions are characterized as: Performance, Management, Budgetary, or Legislative. In FY 2006, for example, a key performance follow-up action for the Superfund Federal Facilities program involved working with other federal agencies to support attainment of long-term environmental and human health goals by reviewing and recommending remedies for cleanup. EPA's New Chemicals Program provides an example of an important management follow-up action which involved developing an efficiency measure targeting reduced costs in the later stages of the Pre-Manufacture Notice (PMN) review process. The table below shows the number of improvement plans in each category as well as the focus of each.

As of FY 2006, EPA has developed 133 follow-up actions. Twenty-three follow-up actions have been completed, 105 are currently active, and 5 have had no action taken to date (for more information see: http://www.Expectmore.gov). Through the PART process and the associated PART Improvement Plans, EPA will continue to work collaboratively with OMB to ensure the effective protection of human health and the environment.

EPA PART Follow-Up Actions

Type of Follow-Up Action	Quantity*	Focus
Performance	65	Focus on improving the Agency's ability to measure, track, and assess programmatic performance and intended environmental outcomes.
Management	51	Designed to improve EPA's program management practices and facilitate the delivery of environmental results.
Budgetary	14	Budgetary proposals designed to ensure that EPA's resources are directed toward delivering strong environmental results.
Legislative	3	Designed to affect EPA programs' legislative requirements so that the program purpose is clear and environmental outcomes can be achieved.

*Quantity totals include all Follow-Up Actions: "completed", "action taken, but not completed" and "no action taken."

During FY 2006, EPA also conducted other types of program evaluations to determine how well a program is working. (Appendix A contains a list by strategic goal of program evaluations and reviews completed in FY 2006.) For example, for the Agency's Office of Solid Waste and Emergency Response and the National Academy of Sciences completed a case study on the Coeur d'Alene River Basin Superfund site in northern Idaho to examine EPA's scientific and technical practices in Superfund megasites. The evaluation found that EPA's practices for human health risk decision making at the Superfund site are generally sound; however, it raised substantial concerns, particularly regarding the effectiveness of the selected remedy. Among other recommendations, the evaluation suggested incorporating U.S. Geological Survey data into EPA's remedial planning and developing a better understanding of dissolved metals to account for movements to and from groundwater and surface water. EPA's National Mining Team has formed a subgroup to carefully evaluate and draft action items for each recommendation.

EPA's OIG contributes to the Agency's mission to improve human health and environmental protection by assessing the effectiveness of EPA's program management and results, developing recommendations for improvement, and ensuring that Agency resources are used as intended. For example, in FY 2006, the OIG reviewed the development of emissions factors under the Agency's Clean Air Program—a critical component of state clean air plans. The OIG sought to determine whether the air emissions factors used by EPA are of acceptable quality for making environmental decisions, and whether EPA's decisions and process for improving and rating emissions factors is sufficient to meet users' needs. The OIG report found that the percentage of emissions factors rated below average or poor increased from 56 percent in 1996 to 62 percent in 2004. In response to the report, EPA is implementing a three-pronged plan to revamp the emissions factor program that includes developing an electronic reporting tool to make it easier for state, local, and tribal agencies to accept, assess the quality, and transmit emissions test data (more information on this evaluation is available in Appendix A).

IMPROVING ENVIRONMENTAL INDICATORS, PERFORMANCE MEASUREMENT, AND DATA QUALITY

Environmental Indicators: To define goals, measure progress, and hold managers accountable for achieving results, EPA needs accurate, timely environmental data.

In FY 2006, EPA continued work to develop and use a suite of scientifically sound indicators to track trends in environmental conditions and human health. This indicator work is based on EPA's *Draft Report on the Environment—2003*. In FY 2007, the Agency expects to release the *Report on the Environment—Technical Document*, which will provide a snapshot of current environmental conditions.

In FY 2006, EPA used the latest set of environmental indicator information in the development of the *2006-2011 Strategic Plan*. Indicator information was used to inform the Agency's 2006-2011 decisions about strategic goals, objectives, sub-objectives, and associated strategic targets, which define the measurable environmental results we are trying to achieve. Information on trends in environmental conditions and human health will also help EPA to identify key environmental concerns and emerging issues and assess the effect of federal, state, local, tribal, and private efforts in improving environmental quality. The Agency plans to continue to use environmental indicator information and the *Report on the Environment* to help inform future strategic planning. More information on the Agency's "Indicators Initiative" is available at: http://www.epa.gov/indicators.

Performance Measurement:

EPA realizes the importance of performance measurement in managing programs effectively, and is continuously working to improve the quality of our measures to make them more meaningful and outcome-oriented. During FY 2006, a number of programs worked to revamp their measures to make them more useful as management tools. For example, in FY 2006, the vast majority of the nation's community water systems supplied drinking water that met all health-based standards, however, some very large systems serving a large number of people (e.g., New York City and San Antonio) reported short-term violations during the year. Because of these short-term violations, EPA did not meet two of its FY 2006 drinking water performance goals. To address this issue and improve the accuracy of the Agency's performance reporting, EPA has developed a new measure that accounts for the time-limited nature of drinking water standard violations which is included in EPA's *2006-2011 Strategic Plan* (see chart below for examples of other measures developed for the new *Plan*).

In addition, to measure and communicate its enforcement and compliance assurance performance

New Performance Measures Developed to Support EPA's 2006-2011 Strategic Plan

These new measures will help EPA fill key data gaps in describing health and environmental trends over time and demonstrate the results of specific environmental programs:

- Mercury Levels in Women: The Agency will track blood mercury levels in women of childbearing age.
- Waterborne Disease Outbreaks: EPA will measure waterborne disease outbreaks from swimming in recreational waters with pathogens.
- Tribal Water Quality: EPA will measure the number of monitoring stations in tribal waters showing improved water quality in one or more of seven key ecological parameters.
- Safe Chemicals: EPA will track the percent of chemicals or organisms introduced into commerce that do not pose unreasonable risks to workers, consumers, or the environment.
- Pesticide Concentrations: EPA will measure the percent reduction in concentrations of pesticides detected in the human population.

results more effectively, EPA is examining ways to move toward a problem-based approach. Currently, the Agency tracks results associated with EPA's four tools for improving and maintaining compliance: compliance assistance, incentives, monitoring, and enforcement. While this approach clearly communicates the strategies EPA uses, linking the results of these tools directly to changes in environmental conditions and human health is challenging. By altering the Agency's performance measures to focus on environmental compliance problems (for example, wet weather or air toxics noncompliance), it will be possible to more clearly link results to precise changes in environmental conditions.

The Agency made considerable progress in FY 2006 in aligning its current performance measures with new performance and efficiency measures developed through OMB's PART assessments. The FY 2007 Annual Performance Plan, developed in FY 2006, contained 119 PART performance measures out of a total set of 179. The Plan also included a detailed list of 144 additional PART metrics with targets still under development (54), as well as long-term targets which were included in the *2006-2011 Strategic Plan* (90).

In FY 2006, EPA used information from PART metrics and follow-up actions, and improved the alignment of annual performance goals in developing its FY 2008 budget submission. EPA also incorporated 92 percent of its PART long-term metrics in the Agency's *2006-2011 Strategic Plan*.

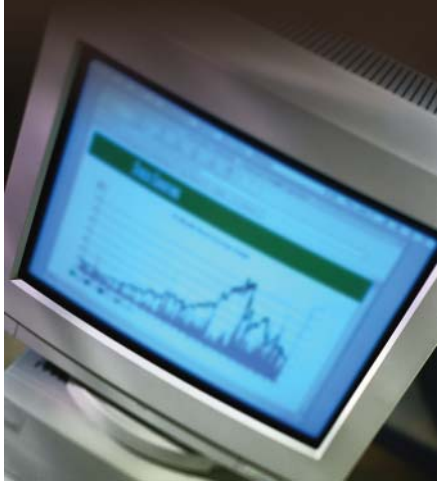
Performance Data Quality: In FY 2006, EPA worked to fill key data gaps and improve the completeness and reliability of its performance data. For example, EPA continued its efforts to transition from program outputs to more ambitious, outcome-oriented performance measures that enable the Agency to better assess cumulative impacts on the environment and human health. (See examples of new outcome measures in table above.) Collecting environmental outcome results and assessing environmental improvement, however, often requires multiyear information. These circumstances largely explain the existence of data lags in EPA's current performance measures. EPA's use of outcome-oriented measures, however, has contributed to the Agency's dissemination of meaningful trend data that provides a more substantive context in which to view the Agency's overall progress and areas for improvement.

EPA managers have also continued to incorporate reliable performance data in their decision making while taking into account known limitations raised by the OIG in data standards, data quality, and data lags. (See Section III for more information on OIG concerns and what the Agency has done to address them.) Efforts underway at EPA to enhance data reliability include addressing programmatic differences in collecting place-based information and assessing the accuracy and usefulness of environmental reporting based on voluntary, third-party contributors. In preparing the Agency's *2006-2011 Strategic Plan*, EPA programs also developed preliminary strategies to address critical data gaps. Often data gaps in EPA's reporting are the result of high costs associated with collecting statistically valid environmental monitoring and human health data. Collaborative efforts between EPA and other federal agencies to combine available resources will help to eliminate these gaps.

Data in FY 2006 Performance and Accountability Report Are Complete and Reliable

EPA determined that the performance information in this report is complete and reliable and no material inadequacies are present, as defined by OMB Circular A-11.

For more information on the data sources used in FY 2006 performance measures and the quality of the data see Appendix B.



IMPROVING AND INTEGRATING FINANCIAL INFORMATION

Federal financial management approaches are changing rapidly. In its 2006 Federal Financial Management Report, the Chief Financial Officers Council envisioned "a Federal Government that, as a whole, increasingly achieves first class financial management practices." EPA endorses this vision and is working with the federal financial management community to learn and share best practices, strengthen internal controls, participate in financial management reforms, support E-Government and E-Travel initiatives, address financial management workforce issues, and improve financial management accountability.

The Agency is committed to developing and providing useful financial information to influence program management decisions and maximize results. EPA's efforts are framed by federal E-Government and Line of Business initiatives that seek economies of scale and use today's technology to improve financial management and accountability, gain efficiencies, and meet today's information delivery and security standards.

Financial System Replacement

EPA is acquiring a new comprehensive financial management system that will better integrate programmatic, performance, and financial information; streamline financial workflow and transform administrative services; and improve the Agency's ability to inform the public. Implementation of the new system is scheduled for FY 2007 to 2009. Detailed plans for this project are available at: http://www.epa.gov/ocfo/modernization/index.htm.

Financial Data Integration

During FY 2006, EPA continued its effort to make financial information readily accessible to inform decision making related to administering and overseeing grants. Initiated in FY 2005, this effort required building a data interface between two operating systems and defining the requirements of an integrated reporting platform. It is planned for completion in FY 2007.

For its next initiative under the Data Integration effort, EPA in FY 2006 began to address emergency management. The key objective of this initiative is to explore ways to improve the Agency's management of financial and administrative information associated with natural disasters and other significant emergencies. EPA will continue to investigate opportunities for producing financial information to improve program efficiency.

Financial Data Accessibility

EPA is also developing an accessible enterprise Administrative Data Warehouse to meet the changing business and data manipulation needs of the Agency's decision makers and analysts. The warehouse will provide a common source of authoritative data, reducing redundant management and data sources. Through this initiative, the Agency will continually update its administrative system architecture, thereby ensuring the most efficient and cost-effective information exchange. The new warehouse will be phased in by the

end of FY 2008 in conjunction with the new financial management system.

Budget Formulation and Execution

EPA is engaged in the new Budget Formulation and Execution Line of Business (LoB) formally launched by OMB in 2006. This effort seeks to improve budget processes and related analytic capabilities government-wide. The Budget Formulation and Execution LoB is to focus on building a "budget of the future," employing standards and technologies for electronic information exchange to link budget, execution, performance, and financial information throughout all phases of the annual budget formulation and execution cycle.

Improving Financial Services and Operations

Building on the recent financial consolidation, EPA management will undertake a comprehensive review of the effectiveness of its financial services functions. The Agency will consider realigning its operations and adopting best practices from other agencies and will continue to further automate its operations to increase efficiency.

EPA will begin using an e-travel software, GovTrip, consistent with the President's Management Agenda goal. GovTrip offers a seamless system that automates end-to-end travel arrangements. It will also interface with EPA's financial system to streamline the reimbursement of a traveler's expenses. The software is scheduled to replace EPA's legacy system in FY 2007.

CONSIDERING FUTURE TRENDS AND LOOKING AHEAD

Rapidly developing technologies and other emerging social and economic changes can have potentially significant implications for the Agency's programs. Several years ago, the Agency began conducting "futures analysis" to help its senior leaders anticipate future environmental challenges and plan strategically to avoid problems. To bring these issues to the forefront, EPA convened a series of workshops in FY 2006, as an integral part of developing the *2006-2011 Strategic Plan*. The workshops were structured around the Agency's strategic goals, and provided an opportunity for senior program officials, key staff, and selected external experts to identify and discuss the implications of some of these issues.

The results of these workshops were used to develop a new section under each of the five strategic goals in the Agency's *2006-2011 Strategic Plan* that addresses the potential new challenges and opportunities the Agency could face over the coming years. Some of the emerging technologies present new opportunities for the Agency to address environmental problems, and some also present novel risks. Anticipating these risks and developing the tools to identify and address them will become increasingly important as these technologies enter the marketplace. EPA's *2006-2011 Strategic Plan* describes potential challenges facing the Agency as illustrated below:

- **Stratospheric Ozone:** Recent scientific studies indicate that the stratospheric ozone layer is likely to take longer to heal than previously anticipated. Therefore, the Agency expects more people to be exposed to excess UV radiation over a longer period. Timely, comprehensive actions by all nations are critical to restoring the ozone layer and protecting people

from skin cancer, cataracts, and other illnesses.

- **Climate Change and Sea Level Rise:** Understanding of the effects of climate change and projected increases in sea levels on the health and productivity of coastal waters and habitats, fisheries, and wetlands is necessary to inform sound environmental management and protection of these resources.
- **Renewable Energy:** Renewable energy and fuel sources such as biofuels could have many implications for EPA. The Agency will need to examine how producing new renewable and non-renewable forms of energy and the infrastructure for distributing and storing them might affect the environment.

EPA's progress over the next several years will depend greatly on our ability and commitment to find more effective tools and approaches to meet today's complex environmental challenges. Broad-based problems, such as polluted runoff, global climate change, and loss of habitat and biodiversity, are often the result of diffuse causes and cannot be solved fully with conventional regulatory controls. Rapid technological and scientific advances can bring breakthrough solutions, but also pose unknown or unexpected environmental and public health risks.

As EPA faces these complex challenges and a tightening federal budget, we increasingly turn to two important strategies that cross all of our goals and programs: finding innovative solutions and collaborating with others. In the coming years, we must work even more effectively with organizations engaged in environmental issues, leveraging limited resources and coordinating our authorities and capabilities. We also must involve other government agencies, businesses, communities, and individuals who might not ordinarily focus on environmental matters, yet have the distinctive expertise, perspectives, and resources to help solve environmental problems.

To make the greatest progress, we will promote an ethic of environmental stewardship that engages all parts of society—businesses, companies, communities, and individuals—in taking responsibility for environmental quality and achieving sustainable results. Environmental stewardship is based on the premise that government cannot meet environmental challenges alone. Rather we need all parts of society to understand how environmental protection aligns with broader social and economic interests and to engage with us in actively creating a sustainable future.

NOTES

1. The Federal Managers' Financial Integrity Act, the Inspector General Act Amendments, the Government Management Reform Act, the Chief Financial Officers Act, and the Reports Consolidation Act.
2. The Regulatory Impact Analysis and supporting documents: http://www.epa.gov/particles/actions.html.
3. *The Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1994-2004*, U.S. EPA 430-R-06-002, April 2006.
4. Data source: http://bea.gov/bea/dn/gdpchg.xls.
5. *Wadeable Streams Assessment: A Collaborative Survey of the Nation's Streams*, draft report, EPA 841-B-06-002, April 2006.
6. Data Source: Integrated Compliance Information System (ICIS), available at: http://www.epa.gov/compliance/data/systems/modernization/index.html.
7. US EPA. "Minnkota Power Cooperative and Square Butte Electric Cooperative." http://www.epa.gov/compliance/resources/cases/civil/caa/minnkota.html.
8. Federal Electronics Challenge: http://www.federalelectronicschallenge.net/report.htm; Environmental Products Environmental Assessment Tool: http://www.epeat.net/docs/Agreement.pdf.
9. Green Suppliers Network (GSN): http://www.greensuppliers.gov.
10. Presidential Green Chemistry Challenge Program Awards: http://www.epa.gov/opptintr/greenchemistry/.
11. Green Chemistry (GC): http://www.epa.gov/opptintr/greenchemistry/.
12. Design for the Environment (DfE): http://www.epa.gov/opptintr/dfe/; Green Engineering (GE): http://www.epa.gov/opptintr/greenengineering/.
13. For specific information about these financial indicators, see: http://www.fido.gov/mts/cfo/public.
14. The Office of Management and Budget (OMB) regularly releases an executive scorecard which rates each federal agency's overall status and progress in implementing the PMA initiatives. The scorecard ratings use a color-coded system based on criteria determined by OMB.
15. US EPA, American Indian Environmental Office. "Target 1 Program Performance Report." Goal 5, Objective 5.3 Reporting System.
16. *New York Times*, December 7, 2005, Scientists Say Recovery of the Ozone Layer may take Longer Than Expected, Kenneth Chang. Available online at: http://www.nytimes.com/2005/12/07/science/07ozone.html?ex=1291611600&en=6e8ca9c8549a6f6b&ei=5090&partner=rssuserland&emc=rss. Date of Access: April 26, 2006.